RECORD AND BRIEFS

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No. 10-1311

In the
Supreme Court of the United States

BLUE BELL CREAMERIES, LP,
Petitioner,

v.

RICHARD ROBERTS, COMMISSIONER,
DEPARTMENT OF REVENUE,
STATE OF TENNESSEE,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Tennessee

PETITIONER'S REPLY BRIEF

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REPLY BRIEF FOR PETITIONER

The Commerce Clause and the Due Process Clause of the Fourteenth Amendment limit a state's ability to tax a multi-state business's income to income earned within the taxing state's borders. The unitary business principle calls for a careful, rigorous analysis of such factors as functional integration, unity of operations, or dependence and contribution. These factors are not a "means to the end of determining the scope of the business at issue" (Resp. Brf. 14), but a means of determining whether there is a nexus or connection between the gain sought to be taxed and the taxpayer's business activities in the taxing state. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777-778 (1992). A constitutional nexus analysis should center on the taxpayer's business activities in the taxing state, the activity generating the gain sought to be taxed, and the source of the gain or revenue to be taxed.

ARGUMENT

I. The Constitutional Analysis Under The Unitary Business Principle Must Focus on the Nexus Between the Taxpayer's Particular Activity in the Taxing State and the Income Sought to Be Taxed.

In its Response in Opposition to the Petition for Writ of Certiorari, Respondent, Richard Roberts, Commissioner, Department of Revenue, State of Tennessee (the "Department" or "Respondent"), frames the opposing argument as an issue of whether the Petitioner Blue Bell Creameries, L.P. ("Blue Bell" or "Petitioner"), an operating subsidiary, is part of a

"single, indivisible ice cream business" with its holding company parent, Blue Bell Creameries, USA, Inc. ("BBC USA"). Respondent's framing of the "ultimate" issue in these very simplistic terms begs the question of unitariness. This Court should not simply assume that Blue Bell and BBC USA are unitary because BBC USA is a pure holding company and has no business operations of its own.

The "ultimate question" at the heart of the unitary business principle is whether there is a nexus or connection between the particular activity and/or the income which the taxing state seeks to tax and the taxpayer's business activities conducted in the taxing state, *Allied-Signal, Inc.*, 504 U.S. at 777-778, not whether there is a "single, underlying activity" between an operating subsidiary and its pure holding company parent. First and foremost, an analysis under the unitary business principle must focus on the particular activity or transaction generating the income sought to be taxed and, more importantly, whether that gain has any connection or nexus to the taxpayer's business activities conducted in the taxing state. The focus of Respondent and the Tennessee Supreme Court on the general level of the so-called "single, indivisible ice cream business" is misplaced and inconsistent with the constitutional foundations of the unitary business principle.

While it is true that Blue Bell recognized the gain from the stock redemption on its own federal income tax return, as it is required to do under federal law, the relevant inquiry is whether this gain had any connection with the taxpayer's business activities in the state of Tennessee. *Allied-Signal, Inc.*, 504 U.S. at 777-778. The gain from the stock redemption

transaction did not in any way further the taxpayer's business activities in the state of Tennessee. Rather, the gain was allocated to the holding company's shareholders to offset the individual shareholder's tax burden realized as a result of the stock redemption transaction.[1]

Although the Tennessee Supreme Court stated that the gain from the stock redemption transaction served an "operational function" because it allowed the taxpayer to "make better use of the taxpayer's existing business-related resources," there was no finding that the gain from the stock redemption was specifically connected in any meaningful way to Blue Bell's business activities in Tennessee. In fact, the Tennessee Supreme Court specifically found that the "production, distribution, and sale of Blue Bell ice cream remained unaffected by the reorganization" that led to the stock redemption transaction. (Pet. Appx. 5a). If this is true, and it is, then there is no nexus between the taxpayer's business activities in the state of Tennessee and the gain from the stock redemption transaction.

The record is clear that the gain from the stock redemption transaction did not go to the taxpayer's business activities in the state of Tennessee, but rather to the holding company's shareholders in Texas. To pass constitutional muster, the gain sought to be

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[1] Contrary to the Department's assertion in footnote 1 of its Response Brief (Resp. Brf. 2), the gain from the stock redemption transaction was allocated to the shareholders of holding company BBC USA. Proceeds from the stock redemption transaction were distributed to the holding company shareholders "for payment of taxes attributable to the capital gains." (Pet. Appx. 6a).

taxed must have some sort of connection to the taxpayer's activities in the state of Tennessee. Here, it did not. The "profit-centric" focus of the Respondent and the Tennessee Supreme Court - that the stock redemption somehow "reduced expenses that detracted from earnings" - misses the point. The gain from the stock redemption transaction benefits the holding company and its shareholders only and does not affect Blue Bell's business activities in Tennessee - the production, sale, and distribution of ice cream. The taxing reach of the Department is unconstitutional here because the state wants to tax a gain that had nothing to do with Blue Bell's business activities in the state of Tennessee.

II. "Enterprise Unity" Based on a "Single Underlying Activity" is Not Sufficient to Establish Nexus Because Nexus Must be Determined by the Source of the Revenue at Issue.

Blue Bell and BBC USA are not unitary simply because there is a "single underlying ice cream business." The Respondent's focus on the "single underlying activity" language in *Mobil Oil Corp.* is misplaced. In *Mobil Oil Corp.*, the phrase "single underlying activity" refers to *how* the income sought to be taxed was generated. *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425 (1980). The gains at issue in *Mobil Oil Corp.*, dividend income from foreign operating subsidiaries, were generated from a functionally integrated business where the parent company, Mobil Oil, was fully operational and functionally integrated with and engaged in the same overall business as its operating foreign subsidiaries. The "underlying activity" that generated the dividend

income sought to be taxed was the same business activity in which the operational parent was actively engaged - the manufacture, sale, and distribution of petroleum. *Mobil Oil Corp.*, 445 U.S. at 428. In fact, Mobil Oil actually conducted its own business *through* its foreign subsidiaries. *Id.*

In Blue Bell's case, this analysis fails because the "underlying activity" that generated the income is not the production, sale, and distribution of ice cream (the taxpayer's business activities in the state of Tennessee), but a stock redemption transaction that took place outside the borders of Tennessee and had no connection with the production, sale, and distribution of ice cream in the state of Tennessee.[2] The Respondent and the Tennessee Supreme Court have focused on the wrong "underlying activity." The relevant "underlying activity" is the activity that *generated* the income sought to be taxed *rather than* the general, underlying business activity of parent and subsidiary.

The nexus with the taxing state in *Mobil Oil Corp.* is clear - the gain sought to be taxed was generated by Mobil Oil's integrated petroleum enterprise. Because of the functional integration between parent and subsidiary, the dividend income was related to Mobil Oil's business activities in Vermont. Here, with no functional integration between parent and subsidiary, and no operational activity by BBC USA, the gain from

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[2] *See* Pet. at 13 ("The stock redemption funds were not generated by Blue Bell's production, sale, and distribution of ice cream in Tennessee and did not have any rational relation to values connected with Tennessee.").

the stock redemption transaction was not *earned* in the course of activities related to Blue Bell's sale of ice cream in Tennessee. In short, Petitioner established with clear and convincing evidence that the income Tennessee seeks to tax in this case was *earned* in the course of activities - a stock redemption transaction - that are unrelated to the sale of ice cream in Tennessee. As this Court articulated in *Mobil Oil Corp.*, "what the [taxpayer] must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum products in this state." *Mobil Oil Corp.*, 445 U.S. at 439.

The Respondent's focus on the alleged "single underlying activity" merely scratches the surface of the necessary constitutional analysis to uphold the State's taxing reach in this, or any, case. This "macro-level" analysis would obviate the need for an in-depth inquiry under the unitary business principle in most cases. A "single underlying activity" is a common thread that runs through many of these cases. For example, *Mobil Oil Corp.* involved a parent holding company and operating subsidiaries engaged in the single underlying business of petroleum production and sales. In *F.W. Woolworth Co.*, the single underlying business of both parent and subsidiaries was "chainstore retailing." *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354, 357 (1982). The fundamental question in all of these cases is not whether there is a single underlying business or activity, nor is it the scope of the business unit, but the nexus between the taxing state and the gain it seeks to tax. The Constitutional analysis under the unitary business principle does not and cannot end with the

mere establishment of a "single underlying activity" between a parent and a subsidiary. A constitutional inquiry must go deeper. Unity under the unitary business principle is not simply a matter of a parent and a subsidiary being in the "same business." If that were the case, there would be no need for the careful jurisprudence developed over the last 30 years under *Mobil Oil Corp.* and its progeny. The focus in all of these cases is whether or not there is a nexus, or a connection, between the gain the state seeks to tax and the taxpayer's business activity in the taxing state. Here, there is none.

III. This Case Presents a Novel Issue That Has Yet to be Addressed Under This Court's Controlling Precedent.

This case presents a fact pattern not yet addressed by this Court or any other federal court. Guidance from this Court is needed to properly define the constitutional limits on the taxing reach of the states. The Respondent is correct when it states that this Court's prior holdings control the outcome of this case, even if the facts are different. (Resp. Brf. 16). Had the Tennessee Supreme Court applied the theories and principles developed by this Court over the last 30 years, perhaps this Petition would not be necessary. However, the Tennessee Supreme Court found that the tests developed under *Mobil Oil Corp.* and its progeny are "ill-suited" for assessing cases involving pure holding companies because pure holding companies do not conduct any business operations. As discussed above, the proper focus is not a shared or common business activity but rather the nexus between the gain sought to be taxed and the taxpayer's business activities in the taxing state.

Blue Bell submits to this Court that the unitary business principle is sufficiently flexible to encompass and address "new methods of finance and new forms of business" as they evolve. *Allied-Signal, Inc.*, 504 U.S. at 786. Unfortunately, the Tennessee Supreme Court's focus on a pure holding company's "lack of operations" places undue importance on form and ignores the necessary substance of the required nexus between the gain sought to be taxed and the taxpayer's activities in the taxing state.

CONCLUSION

The Petition for Certiorari should be granted.

Respectfully submitted,

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